

PROGRAM TO EXPAND MARKETS FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN NORTHEASTERN BRAZIL (PEM)

(BR-0270)

EXECUTIVE SUMMARY

Borrower:	Banco do Nordeste do Brasil (BN)	
Guarantor:	Federative Republic of Brazil	
Executing agency:	Banco do Nordeste do Brasil	
Amount and source:	IDB: (CO)	US\$150 million
	Local:	<u>US\$150 million</u>
	Total:	US\$300 million
Financial terms and conditions:	Amortization period:	20 years
	Commitment period:	3 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	Single Currency Facility in U.S. dollars
Objectives:	<p>The objectives of this program are: (i) to help raise the efficiency and competitiveness of small and medium-sized enterprises (SMEs) producing goods and services in the Northeast of Brazil; and (ii) to create an operating mechanism within the BN for granting loans to SMEs through financial intermediaries. The program will reinforce strategic regional economic development initiatives already being implemented by public- and private-sector agencies, and help eliminate basic obstacles facing entrepreneurs and workers in the manufacturing sector by taking advantage of business opportunities related to natural resources or tapping existing technological capacity.</p>	
Description:	<p>The program will promote and finance technical assistance, training programs, productive investments (machinery and equipment), projects involving innovations (new management methods, products, processes), research and development of new technology, trade</p>	

promotion activities, development of additional infrastructure and institutional strengthening. The instruments for support and financing of these activities will consist of nonreimbursable contributions (NRCs) and medium- and long-term loans. The program will have two components:

1. **Technical assistance, training, technology research and development, export promotion, and infrastructure and institutional strengthening, financed with nonreimbursable contributions (NRCs) (US\$69.3 million)**

This component will include the following activities:

- **Technical assistance (US\$11.3 million):** preparation of strategic plans for improving quality and developing innovative products and processes; metrology, standardization and testing; minimizing losses and improving ecoefficiency and workplace health and safety planning; and marketing studies, policies and new financial instruments.
- **Training (US\$11 million):** awareness raising activities; technical and business training; training on aspects of quality control, environmental monitoring and occupational safety, and training in new technologies.
- **Technology research and development (US\$28.5 million):** research and development (R&D) projects carried out on an individual or cooperative basis; projects for technology transfer and adoption of clean technologies; support for the development of prototypes and precommercial models; technology platforms; and technological projects.
- **Export promotion (US\$3.3 million):** creation of export consortiums; the search for new products and markets; organization of trade fairs and missions to other countries, and support for marketing activities and advertising.
- **Infrastructure and institutional strengthening (US\$15.2 million):** standards, testing and metrology laboratories; business incubators and technology parks; sectoral service centers; and accreditation and information centers on clean technologies.

The NRCs will come from the Ministry of Science and Technology (MCT) and intermediary entities and institutions such as Brazil's Microenterprise and Small Business Support Service (SEBRAE), its Export Development Agency (APEX), and the National Vocational Training Center (SENAI), which will sign cooperation agreements for

contracts with the BN for participation in the program, thereby assuming responsibility for carrying out activities in support of SMEs.

2. Loans for productive investments (US\$224.6 million)

This component will provide support for expansion of the productive sector and technological modernization of processes and products by financing the purchase and installation of equipment, industrial infrastructure and other capital goods, as well as covering other expenses associated with such investments (technical assistance and training activities). The Bank's contribution will be transferred by the BN in the form of onlending to the enterprises through eligible intermediary financial institutions (IFIs).

The Bank's country and sector strategy:

The strategy defined by the Bank for its activities in Brazil is consistent with objectives of the Brazilian government's multiyear plan, in term of providing support for SMEs and eliminating regional disparities. This strategy is designed to give priority to reducing the "Brazil cost" and modernizing the productive sectors, with emphasis on: (i) aiding the national effort to restore required levels of investment in infrastructure; (ii) strengthening the financial sector, with special attention to promoting SMEs and microenterprises through financing for programs to provide access to loans, technical assistance and venture capital; (iii) improving working conditions through support for occupational health programs; (iv) promoting tourism development, particularly aimed at ecotourism and sustainable development of local communities; and (v) establishing adequate regulatory frameworks.

The need to increase sources of financing for SMEs is justified by their ability to generate employment, their flexibility in adjusting to changing markets, their role as innovators and generators of entrepreneurship, and their capacity to make productive use of scarce resources. The business development strategy for the Northeast, drawn up by the Bank identified as strategic areas in which to concentrate support: (i) promoting new financial instruments; (ii) supporting human resource training programs; (iii) strengthening technical support systems for management and cooperation between firms; and (iv) supporting systems for innovation and development of technology.

Environmental and social review:

The environmental procedures of the BN and the Operating Regulations (OR) will include: (i) an environmental feasibility study meeting the technical, legal and institutional requirements of each state and participating agency, for any activities relating to pollution, sanitation, and occupational health and safety of workers; (ii) a strategic environmental assessment in cases where support is provided

to development areas; (iii) mitigation plans for potential adverse social impact; and (iv) actions to facilitate participation by women in the program's activities.

Benefits:

This program is expected to result in increased investment in R&D within the productive sector, and growth in the number of innovative and export firms – aspects which will revitalize the economy. In similar fashion, it is expected to improve the quality and quantity of support services available to SMEs, both those provided by specialized firms and those on offer from private consulting firms.

Important aspects of this process are reflected in the program's contributions to the following: (i) creating the habit and instilling methods of strategic analysis; (ii) imparting the practice of reliance on specialized *expertise* from outside the enterprise; (iii) promoting acceptance of inter-firm cooperation in analyzing problems and seeking cooperative solutions; (iv) expanding credit available to SMEs in the Northeast; and (v) supporting civil society so that the methods used to form strategic committees, create development areas, etc. give entrepreneurs themselves a more active role in identifying problems and solutions.

The benefits accruing to intermediary banks relate to two aspects. First, by participating in the program they will expand their business horizons, extending their services to include clients with other than traditional projects, including innovative technologies and the possibility of reaching foreign markets. And second, the program will provide an incentive for financial intermediaries to approve medium- and long-term loans, which are not common with these entities, facilitating the development of the "know-how" necessary for evaluating this type of operation.

The program will also do a number of things to improve the overall environment in which the firms operate: laying the groundwork for consolidation of the supply of technology and consulting services; narrowing the gap between scientific establishments and firms, and linking their research activities to solve business needs; and building on the as-yet incipient practice of cooperation between technology centers and businesses.

Risks:

A downturn in the macroeconomic situation – which is not predicted, but of course cannot be ruled out – would have a dampening effect on the SMEs' willingness to renovate their production facilities. However, the country's economic performance in 1999 exceeded predictions made at the start of the year, and major changes in economic policies are having a significant impact.

The coordination of resources administered by various institutions is essential to the success of this program. So long as these institutions continue operating according to their own agendas without reference to the PEM, there will be a risk that the above-mentioned coordination will not be forthcoming. This risk will be lessened when, according to plan, appropriate cooperation agreements are signed under the program setting out working methods, objectives and resources.

Special contractual clauses:

Special conditions precedent to the first disbursement of resources under the Bank's loan include: (i) evidence that the version of the Program's Operating Regulations previously approved by the Bank have entered into force (paragraph 3.24); (ii) evidence that the program coordinating unit (PCU) has been created (paragraph 3.2); (iii) approval by the Bank of the model contract for transfer of funds from the BN to the IFIs participating in the program (paragraph 3.19); and (iv) signing of the technical cooperation agreement between the MCT and the BN, and preparation of the work plan for the program (paragraph 3.19). Within 60 days of the signature of the contract between the Bank and the BN, the latter must present the following to the Bank: (i) at least one funds transfer contract signed with an IFI, based on terms agreed upon with the Bank (paragraph 3.19); and (ii) at least one technical cooperation agreement between the SEBRAE or SENAI of a state and the BN, setting out the corresponding participation in the program according to the model previously approved by the Bank (paragraph 3.19).

Poverty-targeting and social sector classification:

This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704) (paragraph 4.18).

Exceptions to Bank policy:

None.

Procurement:

Where applicable, the Bank's standard procedures will be followed for the procurement of goods and services.